E/CONF.39/D/149
1 Nov.1962
ORIGINAL : ENGLISH

UNITED NATIONS CONFERENCE
ON THE APPLICATION OF SCIENCE AND TECHNOLOGY
FOR THE BENEFIT OF THE LESS DEVELOPED AREAS

Agenda Item: D.2.3

United States of America

# THE ROLE OF SMALL AND MEDIUM INDUSTRY IN DEVELOPMENT

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# THE ROLE OF SMALL AND MEDIUM INDUSTRY IN DEVELOPMENT

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1. Large factories are a characteristic feature of the modern industrial economy, but they are not the whole of it. Despite the well known "economies of scale," manufacturing is not always and everywhere more economical in large than in small establishments. This is true even in the highly industrialized countries. It is still more true in newly industrializing countries where markets are smaller, systems of transport, communication, and product distribution are less developed, and there is less experience with large-scale organization. A country will achieve the most productive industrial structure by developing a well chosen combination of large and small manufacturing units, the place of each determined on the basis of economic efficiency.

2. Often, in countries striving to industrialize, small-scale manufacturing has been regarded as an inevitably backward and lagging part of the economy, perhaps to be aided for social reasons and in a rather defensive or protective spirit, but not as a promising opportunity for development. In most industrialization programs, too little attention has been paid to the benefits to be gained by helping existing small industry to modernize and by stimulating the growth of new, modern small industry. A latent resource has thus been overlooked and neglected.

## CHARACTERISTICS OF SMALL AND MEDIUM INDUSTRY

3. Small industry means manufacturing carried on in relatively small establishments. Before giving a quantitative interpretation to "relatively small," however, it will be useful to note some non-quantitative functional characteristics which distinguish small industry from large industry. These are the characteristics which justify separate discussion of the role of small industry in development and the adoption of special development programs for small industry. (Medium industry, of course, stands between small and large industry with respect to these characteristics.)

4. Most important is (1) the relative lack of specialization in management. The small manufacturing firm characteristically depends on "one-man management," generally by an owner-manager, perhaps with a few assistants. The very large firm, by contrast, can have a vice-president for production, a vice-president for sales, a vice-president for finance, and a vice-president for research. Other characteristics are (2) lack of access to capital through the organized securities market and handicaps in obtaining capital and credit through other channels, (3) no special bargaining strength in buying or selling in a major market, and (4) often, though

not always, a relatively close integration with the local community through local ownership and management and dependence on nearby markets and sources of supply.

5. These characteristics give the small manufacturing firm certain disadvantages and certain special needs for types of advice and aid that are not so much needed by large firms. They also confer some advantages, chief of which is flexibility. The close personal contact which "one-man" management makes possible between the manager and workers, customers, and suppliers can be, if the manager is a good one, a source of strength in many ways. This goes far to explain why, and in what kinds of manufacturing, modern, well-managed small industry can compete successfully with large industry--as will be seen below.

## USE OF TERMS

6. One obstacle to clear thinking about the role of small and medium industry in economic development is the confusion over use of terms. A United Nations report on The Development of Manufacturing Industry in Egypt, Israel, and Turkey (1958) refers to manufacturing establishments employing ten or more persons as "medium-scale and large-scale," thus limiting the term "small-scale" to establishments with less than ten persons. A Working Group of the Economic Commission for Asia and the Far East some years ago suggested that small industry be defined for statistical purposes as establishments with no more than 20 employees when using motive power or 50 when not using power.

7. Governments which offer special assistance to smaller manufacturing firms use diverse administrative definitions. In India until 1960 the Government's small industry program was directed to establishments having no more than 50 employees with power or 100 without power and no more than Rs. 500,000 (about US$100,000) of fixed capital. Now there is no limitation on number of employees; only the capital limitation applies. In Japan, various laws for assisting "smaller enterprises" recognize an upper limit in manufacturing of 300 employees, sometimes with a capital limitation of 10 million yen (about $28,000). In the U.S.A., a manufacturing firm is officially a "small business" for purposes of government financial and other assistance if it has fewer than 250 employees, and large if it has more than 1,000, but within the 250-1,000 range it may be classified either small or large, depending on size standards set for different industries. Obviously, discussion of small and medium industry may proceed at cross purposes unless we take care to define what we mean.

8. The most serious confusion results from a tendency to identify smallness with certain other characteristics. Thus, "small industry" and "village industry" are sometimes lumped together, which is unfortunate because small-scale manufacturing goes on not only in villages--that is, in rural areas--but in urban areas as well. More important, smallness and outmoded techniques are often treated as inseparable. The Economic Survey of Europe, 1959, in its illuminating chapters on "Development Problems in Southern Europe and Ireland," refers several times to the "modern" as contrasted with the "small-scale" industrial sector. At present it is undoubtedly true that the great majority of small-scale manufacturers in the less industrialized countries have backward technology, inefficient management, and low productivity. But these are not inevitable characteristics of small industry. There are modern, efficient, small manufacturing enterprises in many countries, and in some of the highly industrialized countries the average labor productivity in small plants is not very far below that in large plants.

9. Any definition of "small" or "small and medium" industry in measurable

terms, as required for statistical studies and for administration of special kinds of aid, cannot avoid a certain arbitrariness. It is like defining "hot" water. And just as the concept of "hot" water depends on whether one is thinking of shaving or of running a steam turbine, so definitions of small and medium industry can reasonably be different in countries at different stages of development and for different purposes. However, it is important to be clear, and it would be advantageous to achieve a fairly consistent international use of terms.

10. There is no single satisfactory way of measuring the size of an industrial establishment. Besides number of employees, other possible measures are capital investment, output, amount of energy used, and relative position in the industry. All of these are relevant in any complete characterization. Number of employees is, however, the most widely available, the most convenient, the most readily comparable internationally, and on the whole probably the least objectionable for general purposes. At Stanford Research Institute, where for some years we have been engaged in basic research and field work on the role of small industry in development, we have decided for the purpose of statistical comparisons (recognizing the arbitrariness of all such decisions) to call manufacturing establishments with less than 100 workers "small industry," those with 100-249 workers (or thereabouts, where census data break differently) "medium," and establishments with 250 or more "large." Within the "small industry" group, we find it wise to separate out, where possible, establishments with less than 10 employees. We label them "very small." Those with 10 to 49 employees we label "the central group," and those from 50 to 99 "small-to-medium." However, one of our field teams which recently worked with the Banco Popular in Colombia on a joint study leading to special measures for small and medium industry development found that in Colombian conditions the most appropriate definitions, both for analytical and program purposes, were: Small factory, 10 or more persons engaged and gross assets below 500,000 pesos (about US$50,000); medium factory, less than 100 persons engaged and gross assets from 500,000 to 2 million pesos (about US$50,000 to US $200,000).

## PROSPECTS FOR DIFFERENT TYPES OF SMALL INDUSTRY

11. It is essential to distinguish a number of types of small industry, for these different types have very different prospects as a country transforms itself from a traditional, pre-industrial into a modern, industrial economy.

12. One important distinction is that between traditional small industry and modern small industry--the latter defined as manufacturing units in which reasonably good application is made of the best science and technology currently available. It is <u>modern</u> small industry, or movement toward it, which holds promise for newly developing countries.

13. It is also important to distinguish between household industry, artisan industry, and small factories.

14. Household industry is manufacturing carried on in or near the home, mainly by family labor. It is sometimes called cottage industry, though more properly this term might be reserved for rural household industry. This is the oldest form of manufacturing, and it is still important in many countries that are striving to modernize. Undoubtedly it will continue to be important in these transitional economies for a long time. Well planned measures to improve and regulate household industry will be needed. But the long-term trend in developing countries will be, and on economic and social grounds ought to be, for household

industry to disappear, save for special functions. Among such special functions are providing work for the handicapped and for dwellers in isolated places, part-time supplementation of seasonal incomes of farmers in some situations, and production of handicrafts of an artistic and quasi-hobby sort. For ordinary production of manufactured goods, household industry is inefficient and is subject to social abuses that are practically impossible to control, such as extremely low rates of pay, long hours, and child labor. Development planners in newly industrializing countries will do well to regard their household industries as a temporary form, to be supplanted over the long term by small and medium factories, artisan workshops located outside the home, and large factories.

15. Artisan industry is manufacture carried on in workshops by craftsmen working singly or with a few hired helpers or apprentices and without extensive division of labor. The craftsman (artisan) is central, and articles are produced for the most part one at a time with individual variations, often to the requirements of a particular customer. The potters, weavers, blacksmiths, shoemakers, bakers, and other ancient crafts are examples of "old line" artisan industry. As a country moves from traditional towards modern economy, some of the old crafts will decline, as a result of competition with factory goods and changes in tastes. Still more crafts will undergo readjustments by which they will become "service trades" and in this form will supplement rather than compete with factory goods. "New line" artisan activities will arise, such as automobile repairing, installation and repair of electrical equipment, and photographic work. Artistic handicrafts, and craftsmanship in the design, decoration, and individualization of factory goods will find increasing markets. Readjustments such as these, especially the growth of service trades, have belied predictions which were common a half century ago in the then industrializing countries of Europe that factory competition would lead to the disappearance of the artisan. The highly industrialized economies of today seem, on the contrary, to be using increasing numbers of artisans whose functions have undergone a transformation from the making of manufactured goods to their installation, servicing, and repair. Often these functions are combined with retail trade.

16. The long-term problem of the newly industrializing countries with respect to artisans is to help them readjust in a changing environment which presents both new opportunities and new competition. The transitional adjustments will not be easy. But the basic strategy must be to help the artisans in one of two ways: (1) Some can be helped to adapt their skills to the rising modern demands, forsaking the declining traditional demands. This means village blacksmiths learning to install and repair irrigation pumps and diesel engines, skilled weavers concentrating on designs and qualities not readily reproducible by machine, shoemakers turning to shoe repairing. (2) Others must be guided into entirely new occupations, preferably occupations for which the demand is rising as development takes place.

17. The small factory is distinguished from artisan industry by its greater division of labor and the consequent need for planning and coordination. The manager rather than the craftsman is the central figure. In larger factories management itself has to be subdivided, and specialists handle such tasks as production management, product design, sales management, personnel management, and financial management. The small factory has much less division of labor in management, and the medium factory an intermediate amount. As already noted, this is a source both of weakness and of strength in the smaller-scale units. If there is right choice of product lines and skilled management, small units can emphasize their areas of strength and avoid those in which they are too greatly handicapped.

18. The outlook for modern, progressively managed small and medium factories in newly industrializing countries is therefore favorable. Well-conceived programs designed to foster this sector can be important tools of development. However, the utility of such programs will depend on the kinds of small manufacturing industry that are encouraged and how they are encouraged. An economically sound program for small and medium industry development is one that fosters selectivity in the choice of product lines and efficiency in production and business operations.

19. The benefits which an industrializing economy can gain by intelligent promotion of this sector may be summarized as follows:

(a) Small and medium firms serve as a nursery for entrepreneurial talent, for growth in some cases into large industry.

(b) Alert owner-managers in intimate contact with market needs and possessing practical technical competence are important sources of product innovation and adaptation.

(c) The limited size of the home market in many newly industrializing countries makes production on the scale that is usual in the major industrialized countries unfeasible. Smaller plants may be able to produce quantities required by the smaller market at reasonable cost, if provided information on current product opportunities and if given technical and managerial guidance and stimulus to efficient performance.

(d) Efficient and forward-looking firms, even though of modest size, can contribute to development of export trade, especially if market exploration is undertaken cooperatively and with government help.

(e) Vigorous small and medium factories help to check monopoly, improving prices and services to consumers.

(f) Small and medium manufacturers are usually local entrepreneurs, and the healthy growth of their firms helps to balance the importation of foreign capital and the growth of foreign-owned enterprises.

(g) Small and medium enterprises add to employment opportunities.

(h) Such enterprises tap sources of capital (especially from family savings and, if the enterprise is successful, from plowed-back profits) which would not otherwise contribute to the country's capital formation.

(i) Small and medium factories can be important in local and regional development and in promoting a more decentralized pattern of industrial growth.

(j) Vigorous small and medium industry helps to create an active tradition of independent initiative by alert individuals and a strong middle class, which in turn is important as underpinning for political democracy.

## THE ECONOMIC BASIS FOR MODERN SMALL FACTORIES

20. It is sometimes asked, "Will not the large manufacturing firms drive out the smaller ones? Can the small enterprise, lacking a staff of specialists and with limited access to capital, compete against large, highly organized, highly capitalized firms?" The answer is that while many small factories can and do compete successfully, others do not compete directly with large factories but rather serve as a complement to them. That many small manufacturing establishments do in fact manage to compete or to co-exist, even in the most highly industrialized environment, is shown in Table 1.

### TABLE 1

### ROLE OF MANUFACTURING ESTABLISHMENTS HAVING FEWER THAN 100 EMPLOYEES

| Country | Year | Percent of all Manufacturing Establishments | Percent of all Manufacturing Employees [1] | Percent of all Manufacturing Output [2] |
|---|---|---|---|---|
| U.S.A. | 1958 | 91 | 27 | 23 |
| West Germany | 1953 | 89 | 27 | 23 |
| United Kingdom | 1954 | 95 | 33 | n.a. |
| Puerto Rico | 1954 | 91 | 41 | 38 |
| Australia | 1955 | 97 | 50 | n.a. |
| Japan | 1952 | 99 | 59 | 37 |

n.a. Not available.

1. United Kingdom, percent of workers.
2. U.S.A. and Puerto Rico, value added by manufacture; West Germany, turnover excluding goods purchased and resold without processing; Japan, value of shipments.

Sources: U.S.A.--Bureau of the Census, Census of Manufactures, 1958.
West Germany--Statistisches Bundesamt, Statistisches Jahrbuch für die Bundesrepublik Deutschland, 1955.
United Kingdom--Annual Report of the Chief Inspector of Factories for the year 1954.
Puerto Rico--Puerto Rico Planning Board, Statistical Yearbook, Puerto Rico, 1957.
Australia--Australia Commonwealth Bureau of Census and Statistics, Official Year Book of the Commonwealth of Australia, 1957.
Japan--Office of the Prime Minister, Bureau of Statistics, Japan Statistical Yearbook, 1954.

21. In the United States in 1958, as the table shows, more than 90 percent of all manufacturing establishments had fewer than 100 employees. These establishments employed 27 percent of all manufacturing employees and produced 23 percent of the total value added by manufacture. Incidentally, the fact that these smaller factories accounted for not very much less in proportion of value added

than their proportion of employment shows that their average labor productivity is not very greatly below that of the larger factories. The relative importance of small factories is as great or greater in West Germany and the United Kingdom, and considerably greater in Puerto Rico, Australia, and Japan.

22. Here are some of the factors which enable small and medium factories to compete or to co-exist successfully with large industry:

(a) Economies of scale are less important in some lines of production than in others. In blast furnaces and cement kilns there are great engineering advantages and cost advantages in using big pieces of equipment to handle large amounts of materials, so that these are not undertakings suitable for small units. But in the manufacture of garments or certain kinds of machine tools the advantages of scale are much less significant, and a moderate sized plant may be just as efficient as, or even more efficient than, a large one.

(b) Small units have an advantage where shipping costs are high or the product is perishable. Thus, bricks and tiles and fresh baked goods can be produced more economically by relatively small, local establishments than by great central factories.

(c) Small manufacturing establishments have an advantage in meeting highly specialized or individualized demands or in catering to a small volume market or one requiring frequent quick readjustments because of style changes or for other reasons. They compete very well in certain kinds of precision instruments, some types of specialized machinery, some types of surgical equipment, women's wear, and so on. Here the flexibility of the small firm stands it in good stead. Large enterprises are handicapped by their bureaucratic procedures and their relatively large overhead expenses. It does not pay for them to produce short "runs" of a non-standard item, but the small factory can often do so at a profit.

(d) Where labor and social laws are applied more stringently to large than to small plants, as is often the case in newly industrializing countries, this may be a factor (whether or not a desirable one) in the competitive ability of small plants.

(e) The small factory can "fill the cracks" between the large-volume, standardized outputs of large factories. Many small manufacturers produce specialized sizes or styles or slightly different products for which the demand is not great enough to justify large-scale production but still large enough to provide an attractive market for them. For example, a very successful small cycle manufacturer near Madras, India, produces junior size bicycles, also tricycles and tricycle-mounted delivery carts, thus supplementing rather than competing with a major bicycle factory in his immediate vicinity.

(f) The small factory can produce components and supplies for large factories. Much of Japanese small industry works on contract for large industry. One of the reasons for the efficiency of industry in the United States is that large plants characteristically buy many specialized parts from hundreds or even thousands of other plants, both large and small. A small enterprise supplying a

specialized item to several large firms may have greater economies of scale on that item than any of the large firms could obtain. Also, small industry often performs job shop operations for large industry.

(g) The small factory often serves to initiate new products, and sometimes grows large with growth of the market for the product. Henry Ford and other pioneer automobile manufacturers started on a very small scale. The electronics industry today is bursting with small firms, as well as large ones, hopefully exploiting new ideas. In countries where industrial diversification is at an early stage, small-scale manufacturers can discover opportunities to introduce products that are new to the country though not necessarily new in the world.

## POLICY IMPLICATIONS

23. The policy implications of the preceding analysis may now be summed up.

24. First, development leaders in countries striving to accelerate the rate of industrial advancement will do well to give attention to the constructive possibilities in modernization and growth of small and medium industry.

25. Second, as a country moves through the transitional stage from a traditional toward a modern economy, the outlook is for household industry to be replaced, for artisan industry to be transformed, and for the small but modern factory to be developed and to increase in importance.

26. Third, these shifts can be made much more productive if they are properly guided. Some product lines and some situations offer opportunities for efficient small-scale manufacturing and others do not. Conditions vary from country to country, from region to region in the same country, and from time to time as a country develops. Therefore, continuous research to provide up to date analysis of changing markets, production methods, costs, and other economic and technical factors is advisable in a program of small and medium industry development. It will also be necessary to have some type of communication system, such as an industrial advisory service or industrial extension service, to carry to existing or potential entrepreneurs the information on which they can base sound investment decisions.

27. Fourth, much depends on improving the efficiency of management in small-scale enterprises and on introducing improved production technology. This again suggests the need for some type of industrial advisory service. Among its functions would be to encourage a progressive outlook among small entrepreneurs and to keep feeding them improved ideas on the economic, technological, and management problems of their enterprises. These ideas should be based on the best modern techniques of production and management, suitably adapted to smaller-scale operations.

28. This last point has a direct bearing on the application of science and technology for the benefit of less developed areas. Significant help could be given in the advancement of the newly developing economies by devoting more scientific and technological effort to the serch for methods of increasing the efficiency of comparatively small-scale production units.

## DESIGNING A DEVELOPMENT PROGRAM FOR SMALL AND MEDIUM INDUSTRY

29. What types of practical development aids should be considered in designing a positive program to improve the efficiency and promote the growth of small and medium industry? The following checklist is offered:

(a) Industrial Advisory or Counseling Services. Some of the principles and techniques that have made agricultural extension services valuable instruments of agricultural improvement are now being applied for small industry development in a number of countries. . A small industry advisory service or industrial extension service should give counsel on two kinds of problems: (1) economic and business management problems, including the choice of promising lines of manufacture, marketing, costing, financing, and personnel management and (2) technical production problems, such as plant layout and better use of machines and materials. An industry advisory service needs a trained staff, closely linked with and backed by industrial training services, research services, financing services, and all the other developmental aids.

(b) Industrial Training Services. For effective development of modern small industry, training programs are needed for: (1) managers, (2) supervisors and foremen, (3) technicians, and (4) skilled workers.

(c) Industrial Research Services. Applied research is constantly needed in order to adapt the best available science and technology to the special needs of existing or potential industries and, through the counseling service, to make the results available to small industrialists. Two kinds of research are important: (1) research on problems of economics and business management affecting the prospects and operations of small industry, and (2) research on technical production problems.

(d) Measures to Improve Small Industry Financing. Small industry generally needs financial counseling. Also, special institutional devices are necessary to cope with the problems and risks peculiar to the financing of this sector of the economy.

(e) Industrial Estates. An industrial estate is a tract of land on which industrial utilities are installed (roads, water, electricity, etc.) and on which standard-type factory buildings are erected for lease or sale to manufacturing firms or on which firms may build their own buildings in conformity with designs approved by the estate. This greatly aids small and medium enterprises, for they are able to have suitable premises and utilities without the burdensome tasks of acquiring land, obtaining all necessary permits, and obtaining access roads and electric power connections. The offer of factory premises on a rental or installment-purchase basis is also a good way of making financial help available to promising small industrial enterprises. Industrial estates are likewise an important tool for city planning and the control of urban growth.

(f) Marketing Aids. The small industrialist, especially if he enters

manufacturing from the craftsman or engineering side, oftentimes fails to do an adequate job of marketing. He can be helped in a number of ways. One of the most important aids is marketing information, based on economic investigations and market surveys which small firms are not in a position to undertake themselves. Trade fairs, expositions, trade directories, and special assistance in making export contacts are helpful devices. Larger firms can be encouraged to contract with smaller firms for component parts and supplies. In some countries a deliberate effort is made to channel suitable portions of government purchases to smaller manufacturers.

(g) Aid in Procurement of Materials and Equipment. The small manufacturer suffers handicaps in purchasing as well as marketing. Therefore, development programs sometimes promote bulk purchasing arrangements for groups of small enterprises, through purchasing cooperatives or governmental agencies. Where important supplies, domestic or imported, are subject to allocation and control it is highly advisable to establish special, simplified procedures adapted to the needs of small manufacturers.

(h) Fostering Interfirm Assistance and Industrial Self-Help. In some countries, such as the northern countries of Europe, trade associations or associations of small industrialists have proved themselves capable of carrying on advisory services, training services, research services, and financial services for their members--often with the aid of government subsidies. Large manufacturing firms can also be an important source of technical assistance for the many small firms among their customers and suppliers. The exchange of ideas and information at trade meetings and conventions, through trade periodicals, and in other ways can be an important factor in industrial progress. Small industry development may well include efforts to stimulate constructive activities of these various types.

30. A development program for small and medium industry need not, of course, include every type of measure on the foregoing checklist. It should, however, be reasonably comprehensive. Usually it does little good merely to set up an institution for making capital and credit more readily available to small industry without, for example, doing anything to improve techniques of production and management. An action program, to be effective, must push outward simultaneously on a considerable number of limiting factors. Which factors are most strategic in the circumstances of a particular country should be determined by a preliminary survey. Usually the limiting factors so revealed will be multiple, and the action program will need to be a broad, integrated one, so that each kind of assistance reinforces the other kinds and is reinforced by them.

31. Each country requires a set of measures tailormade in general approach and in detail to its own situation. Valuable ideas can, however, be had by studying the experience of other countries. Among the less industrialized countries, India has by all odds the largest, most comprehensive, and the best planned program for small industry development. At a further stage of industrialization, Japan has evolved a wide array of measures which well merit study. The United States has an active "Small Business Administration" which aids small and medium manufacturers and other types of small business, supplementing many aids provided through other public institutions and through the private business system. The Scandinavian countries, the Netherlands, Germany, the United Kingdom, France, Italy, and other European countries, also some of the Provinces of Canada, have

adopted a variety of measures with different emphases, sometimes focussing on the financial needs of small manufacturing units, sometimes on technological and managerial training and productivity improvement, sometimes on product design and marketing. In Puerto Rico there is an active industrial development program in which a large proportion of the enterprises that have been started are small units, and a number of other Latin American countries--Mexico, Brazil, Colombia, and others--have special banking institutions designed to stimulate small industry, also industrial development centers, industrial research institutes, productivity centers, and the like. Indonesia, Burma, Pakistan, and the Philippines are using various techniques of small industry promotion, and the Federation of Malaya is strengthening its Rural and Industrial Development Authority. In Africa, Nigeria has been experimenting with industrial estates and other measures and is considering a more comprehensive small industry program.

32. It should be stressed, however, that no system worked out in one country can be recommended in its entirety for another. Rather, the development officials of each country must analyze their particular country's small industry problems and opportunities, then borrow some ideas and invent others, in order to act creatively and practically in their specific situation.

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